HARVARD LAW REVIEW

Published monthly, during the Academic Year, by Harvard Law Students

SUBSCRIPTION PRICE, $2.50 PER ANNUM . . . . . 35 CENTS PER NUMBER

THE COST OF SERVICE AND CONFISCATORY RATES. — Railroad operations present a peculiarly complex application of the economic law of increasing returns,[1] for not only is the initial capital outlay in permanent plant very great in comparison with operating costs, but also from one-half to two-thirds of the expenses of maintenance and operation are relatively constant and impervious to variations in the volume of traffic.[2] Under such conditions it is obvious that up to the capacity of the plant every additional unit of traffic is always worth while, provided only that it affords any return, however small, over and above the actual

[1] Peculiarly complex because they present also the problem of a plant which turns out not one homogeneous commodity, but many kinds of commodities, a part of the cost of which is incurred separately for each, and a part jointly for all. In such undertakings, although generally no commodity will be sold for less than the separate cost incurred in regard to it, the price at which any particular commodity will be sold, over and above this separate out-of-pocket cost, depends not upon any mathematical apportionment of the joint cost of producing all the commodities, but upon the character and extent of the demand for the particular commodity. See MILL, PRINCIPLES OF POLITICAL ECONOMY, Book III, ch. 16, § 1; article by Professor Taussig, 5 QUART. J. of ECON. 438–465.

[2] See RIPLEY, RAILROADS, RATES AND REGULATION, pp. 44 *et seq.;* ACWORTH, ELEMENTS OF RAILWAY ECONOMICS, pp. 5–50; article by Professor Taussig, 5 QUART. J. OF ECON. 438–465; NOYES, AMERICAN RAILROAD RATES, pp. 10–17. For the purposes of this note "operating expenses" are meant to include not only the cost of moving the traffic but charges for maintenance of plant, depreciation, taxes, and all other fixed charges except interest on capital and dividends. "Out-of-pocket costs" include only the actual additional expenses incurred in moving any particular unit of service, exclusive of any share of fixed charges or permanent expenditure.

out-of-pocket expense of moving it.[3] It is equally obvious that there are certain classes of traffic which would not move at all at rates under which they were made to bear their exact mathematical proportion of the burden of operating the entire enterprise.[4] Yet if they can be attracted at any rate in excess of the actual expense of moving them, the income of the railroad is increased and the burdens of other classes of traffic are correspondingly relieved.[5] This has been the accepted theory and practice of railroad rates since the beginning of our railroad history.[6]

The mere existence of this law by no means justifies all the practices to which it has led,[7] but in two recent decisions the United States Supreme Court seems to have given it much less weight than it deserves.[8] *Norfolk & Western Ry. Co.* v. *Conley*, Sup. Ct. Official, No. 197; *Northern Pacific Ry. Co.* v. *North Dakota*, Sup. Ct. Official, Nos. 420, 421. In the first of these cases a West Virginia statute fixing a maximum rate for the transportation of passengers within the state, and in the other a North Dakota statute establishing maximum rates for the intrastate transportation of coal in car-load lots, were held unconstitutional. In each of these cases the rates established were shown to yield a return in excess of the actual out-of-pocket cost of moving the traffic and closely approximating the share of total operating expenses chargeable to the service in question, but contributing little or nothing above this to the profits of the company.

There are two separate and distinct questions involved in the governmental regulation of railroad rates.[9] The first is a question of policy for the rate-making authority alone, as to what is the most just basis upon which to establish rates. Upon this question there has been a considerable conflict of opinion, with the present tendency toward a more exact apportionment of rates according to the proportional share of total

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[3] See RIPLEY, RAILROADS, RATES AND REGULATION, pp. 71 *et seq.;* ACWORTH, ELEMENTS OF RAILWAY ECONOMICS, pp. 51 *et seq.;* HADLEY, RAILROAD TRANSPORTATION, pp. 109 *et seq.;* article by Professor Taussig, 5 QUART. J. OF ECON. 438–465; NOYES, AMERICAN RAILROAD RATES, p. 19.

[4] See RIPLEY, RAILROADS, RATES AND REGULATION, pp. 169 *et seq.;* STROMBECK, FREIGHT CLASSIFICATION, pp. 9–34.

[5] See n. 3, *supra*. This does not necessarily apply to all public services. See Railroad Commission of Louisiana *v.* Cumberland T. & T. Co., 212 U. S. 414, 426.

[6] See RIPLEY, RAILROADS, RATES AND REGULATION, chs. 4, 5.

[7] Personal discriminations and discriminations between localities are generally attributable to this desire of the railroad to attract traffic and build up a demand for its services. For an interesting instance see Railroad Commission of Nevada *v.* Southern Pacific Co., 21 I. C. C. 329.

[8] For a more complete statement of the facts in these cases see this issue of the REVIEW, p. 716. For the report of the North Dakota case in the state court, see State *ex rel.* McCue *v.* Northern Pacific Ry. Co., 26 N. D. 438, 145 N. W. 135. And for the same case on a previous appeal see State *ex rel.* McCue *v.* Northern Pacific Ry. Co., 17 N. D. 223, 116 N. W. 92; Northern Pacific Ry. Co. *v.* North Dakota, 216 U. S. 579.

[9] See 2 WYMAN, PUBLIC SERVICE CORPORATIONS, § 1120; 4 ELLIOTT, RAILROADS, § 1684 *b;* Louisville & Nashville R. Co. *v.* Siler, 186 Fed. 176, 189; Detroit & M. R. Co. *v.* Michigan Railroad Commission, 203 Fed. 864, 870. For this very reason cases in which the court is considering the reasonableness of a rate in the first instance or under statutory power to review the reasonableness of a rate fixed by a commission are to be carefully distinguished from cases in which only the constitutionality of a rate is in issue. See Gulf Central & S. F. R. Co. *v.* Railroad Commission of Texas, 102 Tex. 338, 116 S. W. 795; Morgan's L. & T. R. & S. S. Co. *v.* Railroad Commission of Louisiana, 127 La. 636, 53 So. 890.

operating costs attributable to the respective services.[10] Under present industrial conditions this may be a wise and beneficial policy, but a scrutiny of the various accounting methods used in apportioning the total costs of operation demonstrates that any fair and exact apportionment is a mathematical mirage. At best it can be but an experienced guess, based on arbitrary ratios and percentages.[11] Moreover, such straitjacket methods are opposed to the economic nature and growth of American traffic as shown by the practice of the railroads,[12] and had they been adopted at the beginning of our railroad history, the industrial development of the country would have been seriously impeded.[13]

But the Supreme Court had no occasion in the principal cases to consider the relative justice of these different rate-making policies.[14] The sole question before them was the narrow one of constitutional law: whether these specific rates prescribed by legislative authority constituted a taking of property without due process of law, or a denial of the equal protection of the laws under the Fourteenth Amendment. Upon this question it might be a convenient rule of procedure to hold that proof that a rate does not yield a return commensurate with its allocated share of operating costs rebuts the presumption of its constitutionality and shifts the burden upon the state of showing special circumstances to justify the rate,[15] were it not for the inherent weakness of the proof itself. It is not in accord with constitutional practice to permit the strong presumption of constitutionality in favor of a legislative act [16] to be overthrown by such an arbitrary mathematical division of the economically inseparable costs of production. Moreover, it can scarcely be contended that that which has been the established practice of railroad rate-makers for three-quarters of a century is not due process of law when practised by legislative rate-makers.[17] There are, of course, limits beyond which the

[10] See 2 WYMAN, PUBLIC SERVICE CORPORATIONS, §§ 1190, 1201, 1202, 1227, 1228; Morgan's L. & T. R. & S. S. Co. *v.* Railroad Commission of Louisiana, 127 La. 636, 53 So. 890.

[11] See 2 WYMAN, PUBLIC SERVICE CORPORATIONS, §§ 1193–1196; NOYES, AMERICAN RAILROAD RATES, pp. 17–19, 39. Modern methods of accounting have made possible a comparatively exact distribution of the separate costs incurred with respect to each particular class of service, but the joint costs, such as taxes, overhead expenses, and maintenance charges, which are incurred with practically no relation to the volume of any particular class of traffic, must be apportioned arbitrarily. The methods of apportionment are as various as the cases themselves. *Cf. In re* Arkansas R. Rates, 163 Fed. 141; St. Louis & S. F. R. Co. *v.* Hadley, 168 Fed. 317; Missouri, K. & T. Ry. Co. *v.* Love, 177 Fed. 493; *In re* Passenger Rates, Minneapolis, St. P. & S. S. M. R. Co., 1 Wis. R. Comm. 540, 556, 567; The Minnesota Rate Cases, 230 U. S. 352, 436 *et seq.*

[12] See RIPLEY, RAILROADS, RATES AND REGULATIONS, chs. 4, 5.

[13] See NOYES, AMERICAN RAILROAD RATES, p. 42; RIPLEY, RAILROADS, RATES AND REGULATION, pp. 169 *et seq.;* MEYER, GOVERNMENT REGULATION OF RAILWAY RATES, pp. 86–92.

[14] See Chicago, M. & St. P. Ry. Co. *v.* Tompkins, 176 U. S. 167, 173; Interstate Commerce Commission *v.* Illinois Central R. Co., 215 U. S. 452, 470, 478; Intermountain Rate Cases, 234 U. S. 476, 488.

[15] See Northern Pacific Ry. Co. *v.* North Dakota, Supreme Court Official, Nos. 420, 421, p. 9.

[16] See Chicago, M. & St. P. Ry. Co. *v.* Tompkins, 176 U. S. 167, 173; Minneapolis & St. L. R. Co. *v.* Minnesota, 186 U. S. 257, 264; Willcox *v.* Consolidated Gas Co., 212 U. S. 19, 41.

[17] *Cf.* dissenting opinion of Baker, J., in Chicago, R. I. & P. Ry. Co. *v.* Interstate Commerce Commission, 171 Fed. 680, 692; Minneapolis & St. L. R. Co. *v.* Minnesota, 186 U. S. 257, 267; Intermountain Rate Cases, 234 U. S. 476, 486.

regulation of rates by the state cannot be carried. In general, a railroad is entitled to earn from its entire business a reasonable return upon the fair value of its capital investment, and any reduction which deprives it of such a return is confiscatory.[18] Moreover, the state's power to regulate rates is confined to the business of the carrier within its limits, and any reduction of charges upon that business which throws a disproportionate burden upon the business conducted in other states or in interstate commerce is unconstitutional.[19] And it may well be that a railroad cannot be compelled to transport a particular class of traffic at a rate which does not cover the actual out-of-pocket cost of moving it, since obviously such traffic can contribute nothing to the road's income.[20] Finally, gross inequalities in the rates for different kinds of traffic moving under substantially similar economic conditions may well be interdicted as discriminatory.[21] But the mere fact that each separate class of service does not yield a return exactly equal to its arbitrarily guessed proportionate share of total operating costs does not necessarily indicate that the charge for such service is confiscatory or discriminatory.[22] It has never been thought that a railroad was entitled to earn a fair return from "every mile, section, or other part into which the road might be divided," [23] nor that every additional facility which it might be required to furnish should show a fair net profit to the company,[24] and the court itself concedes in the principal cases that the rates need not be uniform for all commodities so as to secure the same percentage of profit on every class of business.[25] The principal cases will no doubt settle the law contrary to the views here expressed;[26] and in the particular instances before the court the result is perhaps not regrettable, but if every rate fixed by the regulating authorities is to be subjected to this rigid test a serious

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[18] Coke & Coal Ry. Co. *v.* Conley, 67 W. Va. 129, 67 S. E. 613; Smyth *v.* Ames, 169 U. S. 466; The Minnesota Rate Cases, 230 U. S. 352.

[19] Smyth *v.* Ames, 169 U. S. 466.

[20] Chicago, St. P. M. & O. Ry. Co. *v.* Becker, 35 Fed. 883. But see Atlantic Coast Line R. Co. *v.* North Carolina Corporation Commission, 206 U. S. 1; Gulf Central & S. F. R. Co. *v.* Railroad Commission of Texas, 102 Tex. 338, 354, 116 S. W. 795, 796. In the exercise of the police power the state may doubtless compel the rendering of certain services at a loss. See Interstate Consolidated St. Ry. Co. *v.* Massachusetts, 207 U. S. 79, 86.

[21] Lake Shore & M. S. Ry. Co. *v.* Smith, 173 U. S. 684. See 14 COL. L. REV. 442. But it is doubtful whether the company could object to the rates on the ground that they were discriminatory. See Willcox *v.* Consolidated Gas Co., 212 U. S. 19, 54; Tucker *v.* Missouri Pacific Ry. Co., 82 Kan. 222, 225, 108 Pac. 89, 90; Interstate Commerce Commission *v.* Chicago, R. I. & P. Ry. Co., 218 U. S. 88, 109.

[22] Puget Sound Elec. Ry. *v.* Railroad Commission, 65 Wash. 75, 117 Pac. 739. See Minneapolis & St. L. R. Co. *v.* Minnesota, 186 U. S. 257, 267. But see 25 HARV. L. REV. 276.

[23] St. Louis & S. F. Ry. Co. *v.* Gill, 156 U. S. 649; Chesapeake & O. Ry. Co. *v.* Public Service Commission, 83 S. E. (W. Va.) 286. See 13 MICH. L. REV. 407.

[24] Atlantic Coast Line R. Co. *v.* North Carolina Corporation Commission, 206 U. S. 1; Missouri Pacific Ry. Co. *v.* Kansas, 216 U. S. 262; Chicago, B. & Q. R. Co. *v.* Railroad Commission of Wisconsin, 152 Wis. 654, 140 N. W. 296. But see Yazoo & M. V. R. Co. *v.* Railroad Commission of Louisiana, 130 La. 1012, 58 So. 862.

[25] Northern Pacific Ry. Co. *v.* North Dakota, Supreme Court Official, Nos. 420, 421, p. 9.

[26] A previous Note in the REVIEW, accepting for better or worse the current trend of rate-regulating authority, predicted this very fate of economic law at the hands of the courts. See 25 HARV. L. REV. 276.

obstacle has been opposed to an intelligent adjustment of charges according to economic conditions.

MAY A CRIMINAL PENALTY BE SHIFTED? — Whether one upon whom a criminal penalty has been imposed for an act of his own regarded as criminal, may shift the burden of his fine by a civil action against another primarily responsible was squarely presented by a recent English case. *R. Leslie (Ltd.)* v. *Reliable Advertising and Addressing Agency (Ltd.)*, [1915] 1 K. B. 652.[1] The plaintiffs, moneylenders, had been fined for the statutory misdemeanor of sending circulars to an infant,[2] because the defendant agency in addressing envelopes had, contrary to its contract, negligently included a minor's name. The moneylenders were allowed only nominal damages, it being considered contrary to the public interest that one so sentenced should not bear both his fine and costs. The question decided seems never to have arisen in this country. English authority is not abundant, but the question was discussed by way of *dicta* in two cases. The first, in 1834, took the view, in a suit against the managing editor of a newspaper by the proprietor who on his account had been fined for libel, that there was no right of compensation for an injury of this character.[3] The second, at a much later date,[4] attempted to introduce a qualification to this general rule against shifting a penalty. In this case a trooper brought an action of deceit for personal injuries sustained while innocently participating at the defendant's solicitation in the Jameson Raid in violation of the Foreign Enlistment Act.[5] Neither criminal prosecution nor fine was involved, but one judge was of opinion that no public policy precluded one who had been convicted of a crime of which *mens rea* was not an element from receiving full indemnity.[6] Prior to the principal case, this suggested exception does not seem to have been questioned, for in two subsequent cases persons convicted of the minor statutory misdemeanor of selling impure meat or fish succeeded in recovering the amount of their fines against their vendors on warranty without the legality being questioned.[7]

This dividing line of the English decisions allowing recovery over of fines only in the case of lesser crimes, at first sight seems analogous to the distinction in the law of torts as to contribution between tortfeasors. Although as a rule there is said to be no right of contribution, it is now somewhat generally established that there may be a legal adjustment of the loss unless the wrong was conscious, intentional, or immoral.[8]

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[1] A statement of the case appears in this issue of the REVIEW, p. 705.

[2] BETTING AND LOANS (INFANTS) ACT, 1892 (55 & 56 Vict., ch. 4), § 2. MONEYLENDERS ACT, 1900 (63 & 64 Vict., ch. 51), § 5.

[3] Colburn *v.* Patmore, 4 Tyrw. 677, 1 C. M. & R. 73. The case was decided, however, on a point in pleading. *Cf.* Poplett *v.* Stockdale, 1 R. & M. 337 (1825), in which Best, C. J., said, "It would be strange if a man could be fined and imprisoned for doing that for which he could maintain an action at law."

[4] Burrows *v.* Rhodes, [1899] 1 Q. B. 816; see 13 HARV. L. REV. 215, 226.

[5] 1870 (33 & 34 Vict., ch. 90), § 11.

[6] See Burrows *v.* Rhodes, *supra*, 831, per Kennedy, J.

[7] Crage *v.* Fry, 67 J. P. 240; Cointat *v.* Myham, [1913] 2 K. B. 220.

[8] See 12 HARV. L. REV. 176, containing an explanation of the leading case of Merryweather *v.* Nixan, 8 T. R. 186.